

REPORT OF THE AUDITOR-GENERAL TO THE NORTHERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON JOHN TAOLO GAETSEWE DISTRICT MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the financial statements of the John Taolo Gaetsewe District Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2013, the statement of financial performance, statement of changes in net assets and the cash flow statement for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and Division of Revenue Act of South Africa, 2012 (Act No. 05 of 2012) (DoRA) and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-General's responsibility

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the *General Notice* issued in terms thereof and International Standards on Auditing. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

Basis for qualified opinion

Property, plant and equipment

6. I was unable to obtain sufficient appropriate audit evidence relating to other property, plant and equipment, as I could not physically verify the assets. Municipality did not have adequate systems in place to account for assets and supporting documentation for journals raised against other property, plant and equipment was not be submitted for audit purposes. I was unable to confirm other property, plant and equipment by

alternative means. Consequently I was unable to determine whether any adjustments relating to other property, plant and equipment stated as R 21 330 077 (2012: R23 106 079) in the financial statements were necessary. In addition, other property, plant and equipment could not be traced to the asset register.

7. The municipality did not prospectively recognise the effect of the change in accounting estimate in accordance with SA Standards of GRAP 3, *Accounting policies, changes in accounting estimates and errors*. The municipality performed an assessment and revised the useful life and residual values, however, incorrectly made a retrospective application. Consequently, property, plant and equipment are understated and accumulated depreciation is overstated by R1 280 132. Additionally, there is a consequential impact on the accumulated surplus. In addition, assumptions used to perform the assessment to revise the useful lives and residual values of property, plant and equipment could not be obtained, as a result the adjustment made to the depreciation and property, plant and equipment could not be confirmed.

Biological assets

8. The municipality did not retrospectively recognise the effect of the prior year period errors in accordance with SA Standards of GRAP 3, *Accounting policies, changes in accounting estimates and errors*. The municipality recorded biological assets and did not consider retrospective application. I was unable to determine the extent of the misstatement as it was impracticable to do so.

Depreciation and amortisation

9. I was unable to obtain sufficient appropriate audit evidence that management has properly accounted for depreciation for the current year and prior years due the limitation on other property, plant and equipment. I was unable to confirm the depreciation by alternative means. Consequently, I was unable to determine whether any adjustments to depreciation stated as R 2 968 922 (2012: R 3 092 587) in the financial statements were necessary.

Unauthorised expenditure

10. The municipality did not calculate unauthorised expenditure as required by section 1 of the MFMA. In addition, the municipal council condoned the unauthorised expenditure in the prior year contrary to section 32(2)(a)(i) of the MFMA, resulting in unauthorised expenditure stated as R5 972 329 (2012: R5 587 123) in note 46 to the financial statements being understated by R93 950 843 (2012: R78 343 438).

Irregular expenditure

11. I was unable to obtain sufficient appropriate audit evidence that management has properly accounted for all irregular expenditure for the current and prior year due to the status of the accounting records. I was unable to confirm the irregular expenditure by alternative means. Consequently, I was unable to determine whether any adjustments to irregular expenditure stated as R 61 072 688 (2012: R61 024 225) in the financial statements were necessary.

Contingent Liabilities

12. The municipality did not recognise contingent liabilities in accordance with SA Standards of GRAP 19, *Provisions, contingent liabilities and contingent asset*, in note 38 to the financial statements. The municipality recognised contingent liabilities that do not meet the definitions thereof. Consequently, contingent liabilities are overstated by R6 761 291 (2012: R6 053 141)

13. I was unable to obtain sufficient appropriate audit evidence that management has disclosed all contingent liabilities due to the status of the accounting records. I was unable to confirm the contingent liabilities by alternative means. Consequently, I was unable to determine whether any adjustments to the contingent liabilities stated as R6 761 291 (2012: R6 053 141) in note 38 to the financial statements were necessary.

Retirement benefit obligation

14. I was unable to obtain sufficient appropriate evidence for retirement benefit obligation stated as R20 921 944 (2012: R19 286 434) in note 10 to the financial statements due to the status of the accounting records. I was unable to confirm retirement benefit obligation by alternative means. Consequently, I was unable to determine whether any adjustments to retirement benefit obligation disclosed were necessary.

Debt Impairment

15. The municipality did not recognise the impairment of financial assets in accordance with SA Standards of GRAP 104, *Financial instruments*. The municipality did not maintain adequate system to ensure that receivables could be assessed based on their credit risk classification. I was unable to determine the extent of misstatement as it was impracticable to do so.

Unspent conditional government grants and receipts

16. I was unable to obtain sufficient appropriate audit evidence about unspent conditional grants and receipts, as internal controls were not established over the spending thereof prior to the initial entry into the financial records as revenue. I was unable to confirm whether all funds spent in line with the requirements of various grants were recognised in revenue as required by GRAP 23, *Revenue from non exchange transactions*. I was unable to confirm this by alternative means. Consequently I was unable to determine whether any adjustments to revenue and unspent conditional government grants and receipts stated as R60 785 003 and R9 276 469 respectively in the financial statements were necessary.

Cash flow Statement

17. I was unable to obtain sufficient appropriate audit evidence to confirm the accuracy of cash flow statement due to unexplained differences. I could not confirm this by alternative means. Consequently, I was unable to determine whether any adjustment relating to the cash flow statement in the financial statements was necessary.

Expenditure

18. The municipality did not have adequate systems in place to maintain records of expenditure and value added tax (VAT) for goods and services received, which resulted in expenditure being overstated and VAT Payable being understated by R73 407. In addition, I was unable to obtain sufficient appropriate audit evidence for the amounts disclosed as project cost and general expenditure as disclosed in the statement of financial performance. I could not confirm this by alternative means. Consequently I was unable to determine whether any adjustments to project cost stated at R4 012 713 and general expenditure stated at R7 091 863 in the financial statements were necessary.

Fruitless and wasteful

19. The municipality did not include particulars of fruitless and wasteful expenditure in the notes to the financial statements as required by section 125(2)(d) of the MFMA. The municipality made payments in vain which could have been avoided which were not included in fruitless and wasteful, resulting in fruitless and wasteful expenditure being understated by R 991 816.

Commitments

20. I was unable to obtain sufficient appropriate evidence with regards to commitments, as the municipality did not maintain a complete contract register and as a result no commitments were disclosed in the notes to the financial statements. I was unable to confirm the commitments by alternative means. Consequently, I was unable to determine whether any adjustments to the financial statements were necessary.

Financial sustainability

21. Though the municipality has prepared financial statements on the going concern basis, there are a number of indicators that its financial sustainability is uncertain. These include:

- the material under spending of the approved capital budget;
- the increase in the average debtors' payment days to 349.5 days and debtors impairment ratio to 53% from the current year;
- The municipality also incurred net deficits of R1 956 943 (2012: R55 832 351); and
- incurred unauthorised expenditure of R15 992 611 during the current financial period.

Aggregation or accumulation of immaterial uncorrected misstatements

22. The financial statements as a whole are materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following elements making up the statement of financial position and the statement of financial performance and the disclosure notes to the financial statements:

- Payables and legal costs are understated by R213 898
- Revenue and receivables understated by R310 184

In addition, I was unable to obtain sufficient appropriate audit evidence and I was unable to confirm the following elements by alternative means:

- Non current assets held for sale disclosed as R540 139
- Intangible assets disclosed as R397 906
- Interest received disclosed as R1 847 640

As a result, I was unable to determine whether any further adjustments to these elements were necessary.

Qualified opinion

23. In my opinion, except for the possible effects of the matters described in the Basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the John Taolo Gaetsewe District Municipality as at 30 June 2013 and its financial performance and cash flows for the year then ended, in accordance with SA Standards of GRAP and the requirements of the MFMA and DoRA.

Emphasis of matter

24. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Restatement of corresponding figures

25. As disclosed in note 41 to the financial statements, the corresponding figures for 30 June 2012 have been restated as a result of an error discovered during 30 June 2013 in the financial statements of the John Taolo Gaetsewe District municipality at, and for the year ended, 30 June 2012.

Additional matters

I draw attention to the matters below. My opinion is not modified in respect of these matters.

Material inconsistencies in other information included in the annual report

26. I have not obtained the other information included in the annual report. Consequently I have not been able to identify whether the other information to be included in the annual report contains any material inconsistencies to the information in the financial statements.

Unaudited supplementary schedules

27. The supplementary information set out on pages.... to.... does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

In accordance with the PAA and the *General Notice* issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

Predetermined objectives

28. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on page.... to.... of the annual report.
29. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury's annual reporting principles and whether the reported performance is consistent with the planned objectives. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the *National Treasury Framework for managing programme performance information (FMPPI)*.

The reliability of the information in respect of the selected programmes or objectives is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).

The material findings are as follows:

Usefulness of information

30. Section 46 of the Municipal Systems Act requires disclosure in the annual performance report of measures taken to improve performance where planned targets were not achieved. Measures to improve performance for a total of 75% of the planned targets not achieved were not reflected in the annual performance report. This was due to the lack of processes put in place by the municipality to ensure that the measures are put in place to improve not achieved indicators.
31. The Municipal Systems Act, section 41(c) requires that the integrated development plan should form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 57%, 49% and 54% of the reported development priorities, objectives and indicators respectively are not consistent with the development priorities, objectives and indicators as per the integrated development plan. This was due to the fact that management did not adequately consider the requirements of the Municipal Systems Act when preparing

the annual performance report and also did not implement sufficient appropriate internal controls to ensure that the performance management and reporting is reporting is in terms of the applicable legislation and guidelines.

Measurability

32. The National Treasury *FMPPI* requires that performance targets be specific in clearly identifying the nature and required level of performance. A total of 86% of the indicators were not specific in clearly identifying the nature and the required level of performance. This was due to the fact that the management was aware of the requirements of the National Treasury *FMPPI* but chose not to apply the principles contained in the *National Treasury FMPPI*.
33. The *National Treasury FMPPI* requires that performance targets be measurable. The required performance could not be measured for a total of 100%. This was due to the fact that management was aware of the requirements of the *National Treasury FMPPI* but chose not to apply the principles contained in the *National Treasury FMPPI*.
34. The *National Treasury FMPPI* requires that the time period or deadline for delivery be specified. A total of 94% of the targets were not time bound in specifying a time period or deadline for delivery. This was due to the fact management was aware of the requirements of the *National Treasury FMPPI* but chose not to apply the principles contained in the *National Treasury FMPPI*.
35. The *National Treasury FMPPI* requires that indicators/measures should have clear unambiguous data definitions so that data is collected consistently and is easy to understand and use. A total of 94% of indicators and targets were not well defined in that clear, unambiguous data definitions were not available to allow for data to be collected consistently. This was due to the fact management was aware of the requirements of the *National Treasury FMPPI* but chose not to apply the principles contained in the *National Treasury FMPPI*.
36. The *National Treasury FMPPI* requires that it must be possible to validate the processes and systems that produce the indicator. A total of 98% of indicators and targets were not verifiable in that valid processes and systems that produce the information on actual performance did not exist. This was due to the lack of key controls in the relevant systems of collection, collation, verification and storage of actual performance information.

Reliability of information

37. The *National Treasury FMPPI* requires that institutions should have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets.
38. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of information presented with respect to the following development priorities:
 - Municipal transformation and organizational development
 - Basic service delivery
 - Community development services
 - Local economic development
39. This was due to limitations placed on the scope of my work due to the absence of information system and the fact that the institution could not provide sufficient

appropriate evidence in support of the information presented with respect to these development priorities.

Compliance with laws and regulations

40. I performed procedures to obtain evidence that the municipality has complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations as set out in the *General Notice* issued in terms of the PAA are as follows:

Strategic planning and performance management

41. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the Municipal Systems Act.
42. The performance management system of the municipality did not provide for the monitoring of performance and for the measuring and review of performance at least once per year, with regard to each of those development priorities and objectives and against the key performance indicators and targets set, as required by section 41 of the Municipal Systems Act.
43. The municipality did not set key performance indicators, including input indicators, output indicators and outcome indicators, in respect of each of the development priorities and objectives set out in the IDP, as required by section 41(1)(a) of the Municipal Systems Act and the Municipal planning and performance management regulation 1 and 9(1)(a).
44. The audit committee did submit, at least twice during the financial year, an audit report on the review of the performance management system to the council, as required by Municipal planning and performance management regulation 14(4)(a)(iii).
45. The internal audit unit did not audit the performance measurements on a continuous basis and submitted quarterly reports on their audits to the municipal manager and the audit committee, as required by Municipal planning and performance management regulation 14(1)(c).

Budgets

46. Expenditure was incurred in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 87(8) of the Municipal Finance Management Act.

Annual financial statements, performance and annual reports

47. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the Municipal Finance Management Act. Material misstatements of non-current assets, current assets, revenue, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records were provided subsequently, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.

Audit committees

48. The audit committee did not advise the council and accounting officer on matters relating to the adequacy, reliability and accuracy of financial reporting and information, as required by section 166(2)(a)(iv) of the Municipal Finance Management Act.

49. The audit committee did not advise the council and accounting officer on matters relating to compliance with legislation, as required by section 166(2)(a)(vii) of the Municipal Finance Management Act.
50. The audit committee did not review the annual financial statements to provide the council with an authoritative and credible view of the financial position of the entity, its efficiency and effectiveness and its overall level of compliance with legislation, as required by section 166(2)(b) of the Municipal Finance Management Act.
51. The audit committee did not respond to the council on the issues raised in the audit reports of the Auditor-General, as required by section 166(2)(c) of the Municipal Finance Management Act.

Expenditure management

52. An effective system of expenditure control, including procedures for the approval, authorisation, withdrawal and payment of funds, was not in place, as required by section 65(2)(a) of the Municipal Finance Management Act.
53. An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred, as required by section 65(2)(b) of the Municipal Finance Management Act.
54. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the Municipal Finance Management Act

Procurement management

55. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations as required by SCM regulation 17(a) & (c)
56. Sufficient appropriate audit evidence could not be obtained that contract and quotations were only awarded to providers whose tax matters have been declared by the South African Revenue Service to be in order as required by SCM regulation 43.
57. Contracts and quotations were awarded to bidders that did not score the highest points in the evaluation process, as required by section 2(1)(f) of Preferential Procurement Policy Framework Act.
58. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
59. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, as required by section 116(2)(c) of the MFMA.
60. Contracts and quotations were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).

Revenue management

61. A credit control and debt collection policy was not adopted, maintained and implemented, as required by section 96(b) of the Municipal Systems Act and section 62(1)(f)(iii) of Municipal Finance Management Act.
62. An adequate management, accounting and information system which accounts for revenue and receipts of revenue was not in place, as required by section 64(2)(e) of the

Municipal Finance Management Act.

63. An effective system of internal control for revenue was not in place, as required by section 64(2)(f) of the Municipal Finance Management Act.
64. Interest was not charged on all accounts in arrears, as required by section 64(2)(g) of the Municipal Finance and Management Act.

Conditional grants received

65. The municipality did not submit quarterly performance reports to the transferring national officer, the Provincial Treasury and the National Treasury, within 30 days after the end of each quarter, as required by section 12(2)(c) of the Division of Revenue Act.

Asset management and liability management

66. An adequate management, accounting and information system which accounts for assets was not in place, as required by section 63(2)(a) of the Municipal Finance Management Act.
67. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the Municipal Finance Management Act.

Human resource management and compensation

68. Senior managers did not meet the prescribed competency areas as required by regulation 6 and 7 of the Municipal Regulations on Minimum Competency Levels.

Liability Management

69. An effective system of internal control for liability was not in place, as required by section 63(2)(c) of the Municipal Finance Management Act.

Consequence Management

70. The condoning of irregular expenditure was not approved by the appropriate relevant authority, in accordance with the requirements of sections 1 and 170 of the Municipal Finance Management Act.
71. Unauthorised, irregular and fruitless and wasteful expenditure was written-off as irrecoverable without being certified by council as irrecoverable, as required by section 32(2) of the Municipal Finance Management Act.
72. Authorisation of unauthorised expenditure was not done through an adjustment budget, as required by section 32(2) of the Municipal Financial Management Act.

Internal control

I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for qualified opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

73. Leadership did not exercise their oversight responsibility to ensure that the financial statements and general ledger is adequately reviewed before the financial statements were submitted for audit as the municipality did not have individuals that were sufficiently skilled to implement all the GRAP requirements.

74. The accounting officer did not exercise oversight responsibility regarding financial and performance reporting and compliance and related internal controls. The leadership did not ensure that there were processes to ensure reviews are implemented before submission of information as material errors were detected in the financial statements and non-compliance with laws and regulations and internal control deficiencies were noted throughout the audit process.
75. The lack of decisive action to mitigate emerging risks, implement timely corrective measures and address non-performance was evident by the failure of management to adequately address the external audit findings in a timely manner. The municipality failed to properly analyse the control weaknesses and implement appropriate follow-up actions that adequately addressed the root cause. This resulted in the audit findings in the prior year report being recurring in the current year
76. Leadership did not ensure effective management of the SCM policy and deviations, which resulted in processes not preventing irregular expenditure and material non-compliance.
77. The municipality did not review and monitor compliance with applicable laws and regulations.

Financial and performance management

78. Monthly controls (reconciliations and checklists) were not implemented to ensure that the municipality complies with the financial, compliance and performance objectives of the municipality. This resulted in management not being able to monitor the adherence to the necessary requirements.
79. The accounting officer did not ensure that regular, accurate and complete financial statements are prepared that is supported and evidenced by reliable information. The accounting officer did not review and monitor compliance with laws and regulations.
80. Due to the vacancies in key finance staff positions there was an insufficient understanding of the accounting framework. This contributed towards the numerous qualifications in the financial statements of the municipality.
81. The financial statements were not properly reviewed for completeness and accuracy prior to submission for auditing. This resulted in many findings relating to incorrect disclosure.
82. The underlying systems and controls were inadequate to provide reliable and accurate evidence to support the reporting on predetermined objectives. Senior management did not perform an adequate review on the actual performance against predetermined objectives reported. Therefore, no explanations were documented for targets that were not achieved.

Governance

83. The accounting officer of the municipality did not ensure that a fully functional financial and risk unit is established. The municipality did not identify risks relating to the achievement of financial and performance reporting objectives. Consequently, controls were not developed to prevent, detect and correct material misstatements in financial reporting and reporting on predetermined objectives.

OTHER REPORTS

Investigations

84. An investigation is being conducted on allegations that the municipality failed to build a tarred road in the Joe Morolong Municipality. The investigation aims to establish whether the tarred road was built and that funds were utilised for their intended purpose. The investigation was still ongoing at the reporting date.

Kimberley

30 November 2013



Auditing to build public confidence

DRAFT